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FOOD RETAILING BY DISCOUNT HOUSES ^{1/}

A new development in food retailing seems to be under way: Food is being sold by discount houses. The number of these houses is increasing rapidly with the volume of food sold through their food departments growing at an even more rapid pace. Although few trading areas have been penetrated and relatively few discount houses have food departments, trade estimates place food sales by discount houses at an annual rate of \$2 billion (about 4 percent of total retail food sales), a figure that some believe may quadruple in the next 4 years. Food retailers and wholesalers devoted a major part of their convention programs in 1961, to discussions of discount operations--their own or their competitors.

Many of the major supermarket chains are entering the discount field by acquiring groups of discount outlets. Some are obtaining food concessions in existing general merchandise discount houses; others have obtained a limited number of concessions on a pilot basis to determine whether they will enter this field on a wider basis.

Originally, the discount house was a small, one-man enterprise, operating in low rent quarters, carrying no inventory, with the "I can get it wholesale" appeal. Today, most discount houses are modern, attractive, departmentalized, retail establishments, but still operating with the appeal of lower prices. Many of the large, well known retail organizations are now entering this field.

The operations of discount houses vary. Some are closed-door businesses in which participants are eligible for membership either by payment of a nominal fee, or by status in a group such as government employees, veterans, union members, etc., or both. Others are open to all. Some discount houses handle limited lines of merchandise such as clothing or electrical appliances; others carry a wide assortment of lines comparable to those of suburban branches of department stores. Many of the larger discount houses include substantial supermarket operations. Some discount houses operate their food departments as a concession, others as a component part of the discount house.

At present ownership of a discount house, method of operation, and form of organization are diverse. Some discount houses are individual units, operated as single proprietorships, partnerships or corporations. Others are operated by chain-like organizations, which build discount centers, sell the concessions, and operate as a management group performing functions such as advertising, personnel management, public relations, accounting, protection, and property management. Some are multi-unit discount organizations owned by food supermarket chains, and, more recently, by some of the major variety and department store chains, that use a different name for the discount houses.

^{1/} Prepared by Martin Leiman and Martin Kriesberg, marketing specialists, Marketing Economics Division, Economic Research Service. This article is based on a preliminary study of the impact of retail food operations by discount houses, which included a review of literature in the field of discounting; interviews with wholesalers, supermarket operators, retailers, discount house operators; and observations in representative types of discount house retail food operations.

Size and Nature of Discount House Food Operations

Food departments in some discount houses carry a greater variety and assortment of food items than conventional supermarkets. Some, however, limit themselves largely to items with rapid turnover. Many discount-house food departments do two or three times the dollar volume of conventional supermarkets. However, unlike conventional supermarkets, discount food departments do not as a rule carry such nonfood items as soft goods, hardware, or household goods, and health and beauty aids, since these items are stocked in other departments. When discount food sales are considered on a departmental basis, i.e. grocery, produce, and meat, a higher percentage of business is done in the perishable departments than in conventional supermarkets. This is due in part to the absence of nonfood items in the total sales figure used in computing the percentage of grocery sales of the discount house, whereas these items are considered to be groceries in conventional supermarkets. In addition, the pricing policies of discounters may encourage greater purchases of perishables--fresh fruits and vegetables and meats--that generally have a more elastic demand with respect to price at retail than do non-perishables. Although soft goods and other nonfood merchandise are not included in discount center food departments, annual sales for food departments often exceed \$2.5 million. Furthermore, in many discount centers the food department accounts for 25 percent of the total dollar sales volume.

Some conventional supermarket chains have gone into discount operations by enlarging their nonfood departments in selected new stores; in these instances, the food department occupies about 50 percent of the store sales area, and food sales are more than two-thirds of the total dollar volume. Thus, sales per square foot of floor space are higher for the food department. It can be concluded that the greater sales volume of food items relative to space occupied, results from a faster rate of turnover, since unit value is generally greater for nonfoods than for food items.

Little information is available on how efficiently food departments of discount houses are operated. Inspection of discount house supermarkets reveals wide differences in handling methods and facilities, work organization and scheduling, inventory control and space management, etc., that may in part reflect the operating experience of the owners. Operating ratios such as sales per manhour and labor costs as a percentage of sales are not now available. Nor is there good information on prices and margins for items sold in discount houses to compare with information of this type for the same or like items sold in conventional supermarkets.

Many operators of food departments in discount centers have used mass display and marked price reductions to create the same image and consumer enthusiasm that accompanied the introduction of the supermarket. Retailers who operate both conventional and discount house supermarkets indicate that mass displays in discount centers account for greater unit sales than similar displays in conventional supermarkets. They also indicate that though the shopper may have been drawn to the discount house by its bargain image; once she starts her trip through the discount house supermarket's aisles she is not aware of, or concerned with prices for individual items.

Loss leader merchandising is part of the discount house food operation, but there is no evidence to indicate that these departments as a whole are being operated at a loss to generate traffic and sales for the nonfood departments. Moreover, if food sales represent a substantial portion of total discount house sales, it would be impossible to operate the food department at a loss in the long run. Such a loss could not be recouped from sales of nonfood items sold at discount prices. Furthermore, consumer awareness of nonfood prices, especially for appliances, of other discounters and low margin distributors, lessens the possibility of higher margins.

Several factors combine to indicate that the discount house supermarket could have lower operating costs than conventional supermarkets. First, the use of less pretentious interior decor and the trimming of such services as "Kiddie Korner" and the special service meat window, tend to lower costs. Second, consumer purchases in discount houses tend to be larger; hence costs associated with each customer transaction are a smaller proportion of sales. Third, the use of cut-case or tray-pack methods of shelf stocking, which appear to be more acceptable to discounters than to conventional supermarket operators, could help lower discount house supermarket labor costs. Fourth, the retail cost for the discount house supermarket may be less than similar costs for conventional supermarkets because of sharing certain

costs with other occupants of the building that are associated with economies of scale. Fifth, many slow moving and high mark-up nonfood items are not handled; thus, overhead costs incurred by stocking these items are avoided. In addition, advertising costs for closed-door discount houses may be less than comparable costs for conventional supermarkets. Advertising by closed-door discount houses is usually in the form of bulletins mailed once or twice per month, with the costs shared by the various departments of the center. In contrast, most conventional supermarkets advertise one or more times per week in newspapers and/or radio, television, and other forms of paid media. This apparent cost advantage does not usually apply to food departments in open-door discount centers. Most of these firms follow the same advertising procedures as conventional supermarkets.

Impact on Traditional Marketing Patterns

Food trade publications, advertising, and other business papers have published numerous articles on discounting. Most of these articles have discussed firms that were entering the field and the manner of their entry. Little has been published on the economics of discount firm operation or the economic impact of food retailing in this form. The tenor of remarks by various trade spokesmen is that discount houses are here to stay, that they are a means of mass low cost distribution, and that they will show phenomenal growth. Many also contend that discount houses are filling the gap left by supermarkets as they moved from low cost distribution to higher cost, nonprice competitive practices. These business analysts say that discount houses will go through a similar cycle of increasing costs, and hence will in turn be vulnerable to a new type of low cost operation.

On the other hand, there are operators of conventional supermarkets who, despite acquiring substantial discount operations, still have reservations about discounting.

They question (1) the long-run consumer reaction to discounting; (2) the profit potentials of retail food discount operations; and (3) whether the leased departments arrangement, typical of many discount houses, is a weakness that might contribute to the failure of enterprises of this nature. Similarly, a leading grocery wholesaler, selling to conventional supermarkets, smaller food outlets, and discounters, stated that he did not believe that discounters in his trading area can offer price reductions sizable enough to capture a large percentage of the business in the long run. Contrary to this view was the alarm expressed by a progressive voluntary-group wholesaler, whose affiliated stores are faced with considerable discount house competition, over their ability to meet discount house price competition and still operate at a profit.

If the discount houses achieve the food sales volume projected by some trade sources -- \$8 billion in 1966 -- they will have an important influence on traditional patterns of food distribution. At

this stage of our knowledge of the discount house field, and consumer attitudes, images and reactions, these developments appear likely: (1) Discount houses generally will attract consumers who are willing to sacrifice services for low prices. This will have varying effects on conventional food outlets within trading areas, depending on the images they have created in their customers. (2) Competition in the retail food field will grow as some of the large variety and department store chains establish discount units with full-scale supermarket operations. (3) As price competition between discounters and conventional supermarkets intensifies, both will be forced to operate

either more efficiently or to exert price pressure back to the growers and processors. (4) As supermarket firms appraise the implications of discount houses and experiment with different forms of discount operation, there will be a slowdown in the construction of new conventional supermarkets. (5) Discount houses will move into low population density trading areas, where retail development has been slight, inasmuch as they attract people from a much larger trading area than do conventional retail outlets. This will affect small wholesalers and retailers in nonurban areas who have been relatively free from this kind of competition.



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